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Sugar and the North American Free Trade Agreement[1]

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This is part of the Sugar Policy series, which discusses policy issues facing the U.S. sweetener industry in general and Florida's sweetener industry in particular. The objective of this article is to discuss the major sugar issues involved in the development of a North American Free Trade Agreement (NAFTA) among the United States, Mexico, and Canada and NAFTA's most important results.

The North American Free Trade Agreement (NAFTA)

While the United States effectuated a bilateral trade agreement with Canada in 1989, NAFTA seeks to make all of the North American continent (United States, Mexico, and Canada) a free trade area in the near future. The stated purpose of NAFTA is to reduce trade barriers within the region and stimulate overall economic growth.

The Sugar Issues and Concerns

Some of the major issues of concern to Florida and domestic sugar consumers and producers include the size of Mexico's sugar quota in the U.S. market, imports of sugar-containing products from Mexico, and the U.S. re-export program.

Mexico's U.S. Sugar Quota

Mexico's annual U.S. sugar quota prior to NAFTA was approximately 8,000 tons, raw value. This quota reflects Mexico's status as a net importer of sugar. While Mexico's sugar production is roughly 3.2 million tons, sugar consumption growth has outstripped sugar production growth in recent years, leaving Mexico with the requirement of a relatively large sugar import demand.

In the initial deliberations of the North American Free Trade discussions, Mexico requested a 1.65 million ton quota allocation in the U.S. market. Mexico's quota request of 1.65 million tons, raw value, exceeds the 1.52 million ton quota allocated by

1. This is EDIS document SC 035, a publication of the Department of Food and Resource Economics, Florida Cooperative Extension Service, Institute of Food and Agricultural Sciences, University of Florida, Gainesville, FL. First published July 1992; revised June 2002. Reviewed October 2008. This publication is also part of the Florida Sugarcane Handbook, an electronic publication of the Department of Agronomy, University of Florida, Gainesville, FL. For more information, contact the editor of the Sugarcane Handbook, Ronald W. Rice (rwr@ufl.edu), Everglades Research and Education Center, University of Florida, Belle Glade, FL 33430. Please visit the EDIS website at http://edis.ifas.ufl.edu.

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the United States to all foreign quota recipients (40 nations) for the 1991-92 quota year. Such a large Mexican quota would require zero quota allocations to all other foreign nations under the provisions of the 1990 Farm Bill, which required a minimum of 1.25 million tons of U.S. sugar quota to friendly foreign nations. It is unlikely that Congress would ever endorse a NAFTA proposal to concentrate our foreign sugar quotas into the hands of one nation, irrespective of our friendly status with Mexico. Obviously, our foreign sugar suppliers, except Mexico, would oppose such a large Mexican quota.

United States sugar producers are also opposed to a 1.65 million ton Mexican sugar quota. Domestic sugar producers argue that such a large quota is unreasonable for countries that have a net import status. In 1991, Mexico imported 1.5 million metric tons of sugar, raw value, while exporting only 30,000 tons. Domestic sugar producers contend that the real beneficiaries of a large U.S. quota for Mexico would be a few Mexican sugar traders and operators, not Mexican sugar producers. According to U.S. domestic growers, Mexican sugar producers are already supported and protected at prices above U.S. support levels. Mexican traders and operators would reap windfall profits on an increased market of 1.65 million tons by purchasing sugar at depressed world market prices and selling it to the U.S. market for a quota premium of roughly 10 cents per pound.

Mexican government representatives have contended that Mexico could expand sugar output through privatization of the raw milling sector and other strategies that improve grower efficiency and productivity (e.g., freer domestic market mechanisms such as lower interest rates on farm credit and decreased price supports). From the Mexican perspective, a large U.S. sugar quota would provide a key market stimulus for expanded sugar output with reduced Mexican government subsidies.

Imports of Sugar-Containing Products

There has been concern that without proper monitoring and controls, Mexico could establish candy and sugar intensive food processing operations (e.g., maquiladoras) on the U.S.-Mexican border, using highly subsidized, dumped refined sugar from other countries. If such a procedure were permitted, the integrity of the U.S. sugar program would be undermined, and sugar exporters from other countries would find other dumping grounds for their surplus refined sugar.

The U.S. Re-Export Program

The United States was Mexico's largest source for sugar imports in 1991 at 322,000 metric tons, raw value, followed in order by Cuba with 310,000 tons and Brazil with 224,000 tons. Most of the sugar the United States exported to Mexico came under the auspices of the U.S. re-export program, which permits refineries the opportunity of refining foreign raw sugar for re-export to Mexico without having to come under the domestic price environment. This program has saved jobs in the U.S. sugar refining industry and has assisted Mexico with filling a large void in sugar supplies since Mexico's sugar demand has increased significantly in recent years. U.S. sugar refiners contend that any NAFTA agreement should permit the re-export program to function as long as the need for sugar imports exists in Mexico.

NAFTA's Early Discussions

American, Mexican, and Canadian negotiators first met in Toronto, Canada, in June 1991. Despite numerous meetings at the ministerial level, participants remained divided over a number of issues (e.g., how the proposed agreement should address trade issues concerning agriculture, the automobile industry, energy, financial services, foreign investment, rules of origin, and trade dispute settlement mechanisms). Meetings in 1992 in Washington, D.C., during March, and in Montreal, Canada, during April 6-8, were unable to break the deadlock in the talks.

NAFTA's Final Agreement

In November 1993, the U.S. Congress passed legislation authorizing the North American Free Trade Agreement (NAFTA). NAFTA became effective January 1, 1994, following favorable votes in the U.S. House of Representatives (234 to 200), the U.S. Senate (61 to 38), and the Mexican Senate (56 to 2). The Canadian Parliament previously approved the Agreement in May 1993.

NAFTA is designed to eliminate most of the trade barriers among the United States, Canada, and Mexico within a 15-year time period. The original Agreement did not include sugar trade between the United States and Canada, since this matter was covered by the U.S.-Canada Free Trade Agreement of 1989.

Original Sugar Provisions

The original draft of the Agreement between Mexico and the United States regarding sugar permitted Mexico to increase duty-free exports of sugar to the United States from its level of 7,258 metric tons of raw sugar to a maximum of 25,000 metric tons. However, duty-free shipments in excess of the original 7,258 metric ton level was limited to Mexico's net sugar production surplus (domestic sugar production minus domestic sugar consumption).

In the seventh year of the Agreement, Mexico's maximum duty-free access level for sugar exports to the United States would increase to 150,000 metric tons under the same net sugar production surplus provisions specified for the first six years. Moreover, Mexico was permitted to have *unlimited* access to the U.S. sugar market if Mexico became a net exporter for *two* successive years following the sixth year of the Agreement.

These NAFTA sugar provisions created considerable debate. Three of the major issues debated involved the following:

1. If Mexico did in fact achieve unlimited duty-free access to the U.S. sugar market, would there be any access to the U.S. sugar market for the other 39 foreign countries with U.S. sugar quotas?
2. What would be the status and effectiveness of the U.S. sugar program if Mexico dumped huge quantities of sugar onto the U.S. market?
3. How much high fructose corn syrup (HFCS) would be substituted for sugar in Mexico's soft drink industry to permit Mexico to achieve net exporter status in sugar?

During the 1999 NAFTA debates in the United States, these issues were sufficiently reinforced with congressional opposition to the Agreement. With NAFTA in serious trouble in the U.S. Congress in August 1993, the U.S. Trade Representative agreed to U.S. sugar producers' arguments that Mexico's access to the U.S. sugar market should be diminished. Initially, both Mexican sugar producers and the Mexican government balked at concessions to the original agreement. However, at the last minute, the Mexican sugar industry agreed to "watering down" the original sugar agreement via a "side" agreement.

The sugar industry concerns regarding substitution of HFCS for sugar in Mexico's soft drink industry were corroborated by a Congressional Budget Office (CBO) study in July 1993 ("A Budgetary and Economic Analysis of NAFTA"). According to the CBO study, the promise of access to the U.S. market could encourage investment and expansion in Mexico and change Mexico's demand for imports. Mexico could, for example, shift to HFCS in its soft drink industry. Based on 1990 marketing year data, shifting to HFCS sweeteners in Mexico could free up as much as 1.3 million metric tons of sugar for other uses and would account for nearly all of Mexico's imports. This likely scenario was a major factor in the development of the side agreement for sugar.

The Side Agreement on Sugar

Since the text of the original agreement could not be altered, the "side" agreement on sugar involved exchanges of correspondence between the United States and Mexico committing each respective government to certain "clarifications."

In the original agreement, the formula for defining Mexico's net surplus production was simply projected production minus projected domestic consumption. If this formula yielded a positive number, Mexico would be defined as a net surplus producer.

In the "side" agreement, the formula for determining Mexico's net surplus production was amended to include HFCS on the consumption side only. Thus, Mexican sugar production would have to exceed Mexican consumption of both sugar and

HFCS for Mexico to be considered a net surplus producer. It was believed that this aspect of the "side" agreement would severely diminish Mexico's chances for becoming a major sugar supplier to the United States.

For phase one of the "side" agreement (years 1 through 6, or 1994-99), Mexico would have duty-free access for sugar exports to the United States for the amount of its net surplus production, up to a maximum of 25,000 metric tons, raw value. If Mexico was not a net surplus producer, it would still have duty-free access for 7,258 tons, or the minimum "boat-load" amount authorized under the U.S. tariff rate quota. For comparison purposes, Mexico exported an average of 12,667 metric tons in the four years prior to NAFTA.

In phase two (years 7 through 14, or 2000-09), Mexico would have duty-free sugar access to the U.S. sugar market for the amount of its surplus as measured by the formula, up to a maximum of 250,000 metric tons, with minimum duty-free access still at the minimum "boat-load" amount.

The "side" agreement eliminated the unlimited sugar access provision that was contained in the original NAFTA language. That original provision would have allowed Mexico, after the seventh year, to have duty-free access for its total net production surplus, without limit, provided that it had previously achieved a net production surplus for two successive years.

Sugar Tariffs

The United States has a two-tiered tariff system that permits Mexican sugar to enter the U.S. duty free within their sugar quotas. However, Mexico can export sugar to the United States beyond its quota by paying the second-tier tariff of approximately 17 cents per pound, raw value. Under NAFTA, this second-tier tariff was scheduled to decline 15 percent (total) over the first six years and then to zero by year 15. By the end of the sixth year of the Agreement, Mexico would also install a tariff rate quota system, with a second-tier tariff applicable to other countries that is equal to the U.S. second-tariff. In effect, both countries would have reduced their second-tier tariffs between themselves to zero by the fifteenth year of the Agreement.

The Mexican tariff on HFCS from the United States was 15 percent. It was expected to decline to zero over the next 10 years under NAFTA. Mexican barriers to sugar-containing products would be converted to tariffs and then decline to zero over the 10-year period.

U.S. Sugar Re-Export Program

The U.S. refiners shipping sugar to Mexico under the U.S. refined sugar re-export program would be guaranteed "Most Favored Nation" treatment, without NAFTA providing any special benefit for re-export sugar because it was not considered U.S. in origin. NAFTA did, however, allow for reciprocal duty-free access between the United States and Mexico for refined sugar that is refined from raw sugar produced in Mexico or the United States.

Implications

The primary result of the sugar "side" agreement is that NAFTA would not become a source for domestic market disruption via a dramatically altered sugar price support program or modified tariff rate quota system. NAFTA reinforced the status quo. That is, Mexico was not expected to export vast quantities of sugar to the United States, thereby undermining prices and the integrity of the sugar price support program. Moreover, the United States would not have to dramatically reduce or eliminate sugar quotas to 39 countries holding U.S. sugar quotas.

Further Developments

A few years after the signing of the treaty, Mexico did achieve net-surplus-producer status, which was threatened by the increasing Mexican use of imported HFCS. Mexico contended that in the years following the signing of the "side" agreement, the United States had been dumping HFCS. Since 1998, Mexico has also been complaining about its U.S. tariff rate quota, and Mexican officials (who feel that the U.S. sugar market has not opened fast enough) have demanded greater access. Domestic producers in the United States oppose Mexico's claims. Some Mexican officials have denied ever

signing the famous "side" agreement of NAFTA; others have not. At the 1998 International Sweetener Symposium, the head of Mexico's NAFTA office in Washington, D.C. called for renegotiation of the provisions set by the "side" agreement after 2000. According to him, Mexico should be allowed to send its entire future surplus production to the United States and not the 250,000 tons agreed upon in the treaty. In 2002, the sugar dispute still has not been resolved.